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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 873

AFFILIATED ENTERPRISES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 69–83) is reported at 42 B. T. A. 390. The opinion of the Circuit Court of Appeals (R. 94–102) is reported in 123 F. (2d) 665.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 11, 1941 (R. 102). The petition for writ of certiorari was filed on January 16, 1942. A petition for rehearing was filed December 8, 1941 (R. 103-113), and denied December 16, 1941 (R. 114). The jurisdiction of this Court rests on

Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner was a "personal holding company" subject to the surtax imposed by Section 351 of the Revenue Acts of 1934 and 1936. This depends upon whether income received by it from certain licensing agreements with theatres were "royalties" within the meaning of Section 351.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix A, *infra,* pp. 8–10.

STATEMENT

The facts as found by the Board of Tax Appeals may be stated as follows (R. 70–77):

The petitioner was incorporated on November 16, 1933, for the purpose of promoting a system of giving away money prizes by lot in places of entertainment and operated under several names, but the one most commonly used was "Bank Night" (R. 70). During the taxable years, petitioner was engaged in a nation-wide business of promoting and vending the use of its system, which was offered to theatre operators as a method of advertising to increase patronage (R. 75). Petitioner's stock was owned first by three persons and later by five persons (R. 70).

Petitioner leased the use of its system for money consideration under written agreement called Bank Night license agreements. The printed form

of agreement recites that the petitioner is the owner of the copyrighted name "Bank Night," and of certain copyrights and patent pending of certain cards, register, film trailers, record books, and other accessories to be used in staging Bank Night. The second party is called a licensee, and the agreement recites that the licensee desires to acquire a limited license to use Bank Night in its theatre. The petitioner reserves the right to defend in the name of the licensee any court proceeding against the licensee attacking its right to exercise the license granted by the agreement. The licensee acknowledges petitioner's ownership of trade-marks, copyrights and patent pending, and also acknowledges that it is paying only for the rights that the petitioner may have in the things mentioned (R. 72).

In a majority of the agreements executed by petitioner, the consideration for the use of the system was from $5 to $10 a week and was not based upon the substantial increased profits which resulted from the use of the system (R. 72).

In connection with the use of the system, petitioner supplied the required materials and gave advice and instructions as to the way to use the system in different localities. Initial supplies, which cost petitioner $15 per theatre, were furnished without extra charge, but additional supplies were sold at a small profit by petitioner at agreed prices (R. 72–73).

In carrying on this business, the petitioner had distributors in key cities of the United States who

obtained the license agreements and enforced compliance with the "Bank Night" instructions (R. 74).

Petitioner has never owned a patent on its Affiliated System. Yaeger made application, on November 21, 1933, for a patent on "Means for Conducting Prize Drawings," but it was rejected on January 16, 1934. An amendment to the application was rejected on April 11, 1935. Petitioner made applications for patent in 1937 and 1938, which were rejected in the same years on the holding that "the art cited is unpatentable." The period for appeal from these rejections has expired (R. 73).

Petitioner filed applications in most states to register the name as a trade-mark applying to a system of "free give-aways" (R. 73).

Petitioner obtained copyrights on certain film trailers, instruction sheets which described the method of operating the system, and special notice stating that Bank Night is an advertising system. These copyrights were obtained in 1933, 1934, and 1935. The copyrighted materials were used for various lengths of time in the taxable years until substitutes were copyrighted. After September 1, 1934, no attempt was made to copyright trailers (R. 73).

The gross income of the petitioner from its licensing agreements amounted to 80% of its total income (R. 82) and increased from $100,028.93 in 1934 to $755,573.37 in 1936 (R. 74).

The Board held the income received from such agreements did not constitute "royalties" and therefore ruled that the petitioner was not a "personal holding company" within the meaning of Section 351 (b) of the Revenue Acts of 1934 and 1936 (R. 82–83). The Circuit Court of Appeals reversed (R. 102).

ARGUMENT

This case was correctly decided by the court below in accordance with applicable Treasury regulations, and does not present any conflict of decisions.

The only question involved is whether the petitioner received 80% of its gross income from "royalties," so as to render it a "personal holding company" within the meaning of Section 351 of the Revenue Acts of 1934 and 1936 (Appendix, *infra,* pp. 8–9) and subject it to the surtax imposed therein.

Article 351–2 of Regulations 86, promulgated under the Revenue Act of 1934 (Appendix, *infra,* pp. 9–10) defines royalties as including amounts received for the use of:

> * * * patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and *other like property.* [Italics supplied.]

This definition has appeared in all subsequent regulations. See Article 351–2 of Regulations 94, Article 403–1 (3) of Regulations 101 and Section

19.502–1 (3) of Regulations 103. Such administrative construction must be given effect unless contrary to the statute. Cf. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102–103; *Textile Mills Securities Corp.* v. *Commissioner*, No. 34, present Term. That the definition correctly interprets the statute is confirmed by decisions holding that income resulting from the use of an idea or article not covered by a patent may properly be called a "royalty." *Lane-Wells Co.* v. *Commissioner*, 43 B. T. A. 463; *Volk* v. *Volk Mfg. Co.*, 126 Atl. 847, 849; *McGill* v. *Holmes, Booth, & Haydens*, 48 App. Div. 628 (N. Y.); cf. *Puritan Mills* v. *Commissioner*, 43 B. T. A. 191.

True, petitioner did not have standing to maintain infringement suits against those who used its ideas without compensation, since it had no *exclusive* right in the system after it had become known. *Affiliated Enterprises* v. *Gruber*, 86 F. (2d) 958 (C. C. A. 1st). But its contracts with the licensees were nevertheless intangible property rights which gave rise to recurring payments similar to income received from the use of patents, copyrights, etc., and the general term "royalties" should be construed so as to embrace such payments.

Nor is it important that petitioner received recurring *fixed* amounts from its licensees.[1] The in-

[1] Although the term "royalty" is frequently employed to denote a varying amount reserved by a grantor for the use of his property, measured by the extent of use, fixed royalties are

come was doubtless made payable in this manner because of the difficulty in determining what proportion of the profits of the licensees would be attributable to petitioner's system.

These payments were not "rents," which were excluded from Section 351. The term "rent" generally refers to the return received for the use of corporeal property,[2] and in explaining why rents were excluded from Section 351 the reports of the Congressional committees indicate that the term "rents," although treated very broadly, was nevertheless considered in its commonly understood sense. See Appendix B, *infra*, p. 11.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1942.

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also familiar in the business world, witness the well-known preproduction bonus or advance royalty in the oil business. See also *Horner* v. *Gas Co.*, 71 W. Va. 345; *Maxwell* v. *Faust Co., Inc.*, 90 Misc. R. 702 (N. Y.); *Simonds Rolling &c Co.* v. *Pope Manuf. Co.*, 180 Mass. 393.

[2] See Bouvier's Dictionary (Rawles 3rd Revision); Black's Dictionary (3rd Edition); *Fairchild* v. *Gray*, 136 Misc. R. 704 (N. Y.).